

FEBRUARY 2008

The calendar year just completed was one of the most significant years in terms of changes impacting on Australian estate planning, superannuation and structuring of investments and businesses. The purpose of this briefing is to provide a general summary of how those changes might have an impact and to alert readers to possible review issues which their clients (or they themselves) may need to consider. (At this stage there are fewer changes in these areas on the radar for 2008, although that could change quickly with the release of Government announcements, Court decisions or Revenue Office rulings.) Note: other overviews and updates, eg the overviews referred to in this update, pocket summaries and the regular **EPSS** Advisor Update, are available at www.MooresTraining.com.au. An index of the update is set out below.

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Queen Street and Mornington Offices & MOORESLEGAL EPSS Personnel

In 2008, **MOORESLEGAL** will have 3 Victorian locations available for client meetings, ie the existing full service Box Hill office (at which all staff spend either all or at least part of each week and to which all telephone calls, mail and faxes should be made or sent) and our serviced offices at 10/350 Queen St, Melbourne and Mornington. Appointments can be arranged at our Queen St office with **Allan Swan** (based there 3 days each fortnight, including all Wednesdays), **Jennifer Dixon**, **Philip Curtis**, **Louise Barbaro**, **Suhanya Ponniah** and **Jennifer Jackson**.

Appointments can be arranged at our Mornington office with **Rohani Bixler** (based there every Tuesday and Thursday), **Allan Swan** (based there every 2nd Tuesday) and **Andrew Simpson**.

The current **EPSS** team is as follows:

Principals:

Allan Swan, Jennifer Dixon, Philip Curtis and Andrew Simpson

Senior Lawyer:

Krista Fitzgerald (due to return from family leave mid year)

Lawyers:

Louise Barbaro, Suhanya Ponniah, Jennifer Jackson and Rohani Bixler

Administrative Assistants:

Sarah Parker, Diane King, Jessie Lau and Rachael Barnewall (Colleen Cameron will be on family leave from next month)

Other MOORESLEGAL Private Client Services Contacts:

- **Property:** Andrew Boer, Peter Loftus and Andrew Sudholz
- **Family Law:** Stephen Winspear and Peter Szabo
- **Executive Employment:** Frances Anderson and Peter Andrew
- **Elder Law (and Estate Administration and Litigation):** Andrew Simpson and Anna Hacker
- **MOORETRAINING:** Allan Swan

For information regarding each of these areas and the commercial and other legal services offered by **MOORESLEGAL**, see www.mooreslegal.com.au.

Contributions to Superannuation

In addition to tax free pension and annuity income for people over 60 years of age, a simpler, but more restrictive régime for contributions to superannuation has been in place since 1 July 2007 with relatively limited exceptions for the sale of small businesses and for contributions funded from compensation for illness or injury, eg trauma insurance. While maintaining a tax free income system for people over age 60 might not be economically sustainable as the proportion of the population grows, it is likely that pension and annuity income will remain more favourably taxed than other forms of income in the future.

In addition to the need to plan the level of contributions to superannuation going forward, non-estate planning review issues that the ongoing limitations on annual contributions to superannuation have triggered include the need for forward planning when acquiring assets that are likely to be generating income in retirement years. The transaction costs, eg CGT and State duty, of moving assets into superannuation can be significant and the transfer of certain assets, eg residential property, from a member to a superannuation fund is prohibited. As is highlighted below, it may be preferable to look at alternative methods of acquisition, eg instalment warrants or (in the case of real estate) fixed unit trusts (with non-superannuation fund unitholders holding income only entitlements).

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Further reading: *Self-Managed Superannuation Funds* in the **Superannuation** folder at www.MooresTraining.com.au.

Instalment Warrants

There has been a longstanding prohibition on superannuation funds borrowing to fund investments. On 24 September 2007, this prohibition was relaxed to a significant degree by the inclusion of subsection 67(4A) in the Superannuation Industry (Supervision) Act (1993). Subject to this Act, this subsection allows the purchase of listed securities, real estate and other investments via an instalment warrant, the key components of which are:

- The instalment warrant contract under which the asset is acquired via 2 or more instalment payments;
- A lender, eg a bank, other financial institution or an associate of the superannuation fund members to provide all or part of the finance for the purchase, and
- An instalment warrant trust appointing a trustee to hold the asset during the period between the commencement of the contract and the payment of the final instalment.

At the time of writing, there is still uncertainty about aspects of the instalment warrant system, particularly for the operation of the various State and Territory laws imposing duty on the purchase of real estate to be held initially via an instalment warrant trust and then eventually to be transferred to the trustee of a self managed superannuation fund.

Further reading: *Instalment Warrants and SMSFs* in the **Superannuation** folder.

Fixed Unit Trusts and Real Estate

For real estate, fixed unit trusts are a longer standing alternative to the use of instalment warrants for trustees of self managed superannuation funds not wishing or able to immediately fund the acquisition of:

- Residential real estate from 3rd parties (and to be leased to 3rd parties); and
- Commercial real estate.

Key features of any post 1999 unit trust arrangement involving self managed superannuation funds ("SMSFs") include:

- The need for all permitted dealings, eg leases, with related parties to be on arm's length terms;
- No gearing by the trustee of the unit trust (non-SMSF unitholders can borrow, but must not use the trust property as security); and
- Fixed entitlements for all unitholders.

To minimise or eliminate future CGT on the disposal of the real estate or the units, it is often preferable for the non-SMSF unitholders to hold non-capital (preference or

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non-preference) units and the SMSF to hold ordinary units (including entitlements to capital).

Further reading: *Unit Trusts, Real Estate and SMSFs* in the **Superannuation** folder.

Hybrid Trusts

During 2007, hybrid trusts received considerable publicity as a vehicle for acquiring non-superannuation investments. Some of the publicity was realistic, some was probably optimistic and there is considerable doubt that much of the optimism regarding hybrid trusts, and negative gearing in particular might be shared by the Australian Taxation Office or the Courts. Essentially there appear to be 2 main uses for hybrid trusts, ie as:

- An investment entity, with the trustee issuing short to medium non-capital preference or non-preference units which the unitholder funds by 3rd part finance – it is recommended that the return on these units be either positively geared or have a realistic prospect of becoming positively geared prior to redemption; and
- A trading entity for those professional practices and other businesses that are unlikely to generate income losses and will not be holding listed or unlisted securities in this entity.

Due to their flexibility, hybrid trusts are not suitable investment vehicles for the trustees of superannuation funds.

Further reading: *Unit Trusts – Fixed v Hybrid* in the **Structuring and Trusts** folder.

Family Trust Elections

Considerable uncertainty exists in relation to family trust elections, in particular an issue for many shareholding family and hybrid trusts. The current Government has foreshadowed that some or many of the recent changes that were made in relation to family trust elections may be modified or reversed. This uncertainty, and the Australian Taxation Office's insistence that a cloned trust have the same living test individual as the parent trust, may lead people that are contemplating splitting or cloning a trust to move sooner rather than later.

Further reading: *Family Trusts Elections* in the **Structuring and Trusts** folder and *Cloning and Splitting Trusts* in the **Pocket Summaries** folder.

Spouse Ownership of Business Premises and Intellectual Property

Most of the changes to the provisions governing the CGT treatment of realisation of small business assets have been largely positive from a taxpayer viewpoint. It remains important, however, to check whether the assets that form an integral part of a business are in fact eligible for the concessions – too often mistakes are made

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when assets are acquired and it can be impossible, impractical or expensive to correct that ownership down the track.

Business premises in many instances have greater potential to qualify for the CGT concessions, particularly when sold or transferred – in some cases after the associated business is sold, transferred or ceases to operate.

One problem created by the new amended legislation that came into effect on 1 July 2007 is that the new definition of affiliate makes it much more difficult for a spouse (legal or de facto) to own assets integral to a business, eg business premises or intellectual property, and still qualify for the CGT concessions. Depending on transaction costs such as CGT or State duty, it may be desirable for those “integral” assets to be transferred to a person or entity that does qualify for the CGT concessions or for the spouse to take up equity in the business.

Further reading: *Small Business CGT Concessions* in the **Structuring and Trusts** folder.

Asset Protection

After several years of continuous change and legislation by announcement in relation to bankruptcy legislation, 2008 opened with the backlog of legislative change having been finally enacted. Superannuation (contributions to which are not subject to the standard 4 year clawback period, although subjective anti-avoidance can still apply) has emerged as a premium vehicle, but for non-business and non-personal use asset protection only, as have special disability trusts.

One area of uncertainty on the bankruptcy front is just how far the Courts will go in terms of an approach that is closer to a family law style approach to spouse and family trust ownership, given cases such as **Cummins** and **Richstar**. Issues such as the source of funds to meet maintenance expenses and to achieve debt reduction have become important asset protection issues to consider. The purchase of a house funded by a testamentary trust, the earnings of a low risk spouse or business profits may be preferable to funding the purchase from the personal exertion earnings of an “at risk” spouse.

It is also important to consider the extent to which key assets such as business premises and trademarks and other intellectual property have been and can be separated from business risk and whether appropriate agreements are in place, eg to preserve the validity of a trademark.

Further reading: *Structuring Options for “At Risk” Investors* and *Intellectual Property*, both in the **Structuring and Trusts** folder.

Guarding Against Family Member Relationship Breakdown

The powers of the Family Court in relation to making orders binding on assets owned or controlled by 3rd parties is now very significant when orders are being sought in relation to a property settlement between parties to a marriage (usually, but not necessarily associated with the breakdown of that marriage). Superannuation

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member accounts and pensions and annuities became divisible in late 2001. In late 2004, 3rd parties administering family trusts and other entities became bound to follow Family Court orders in relation to distribution of capital or other decisions. In 2006, the Family Court was required to consider the rights of creditors in determining or approving the terms of a property settlement.

In 2002 it was proposed that these powers extend to domestic relationships other than marriages. The State and Territory Governments have passed enabling legislation to allow this to happen, but this has not happened as yet on the Federal front.

Despite all these changes, there are still a number of things that can be done to maximise the protection of assets impacting on one or other of the parties to a domestic relationship. The Wills of a parent, grandparent or non-surviving spouse can be drafted to include beneficiary or executor controlled testamentary trusts that in practice are more likely to be viewed by a Family Court judge as being a resource available to a party to a relationship, rather than an asset that should be divided.

The level of protection offered by a testamentary trust is significantly increased if the primary beneficiary has entered into a binding financial agreement (requiring the informed consent of both parties to the relationship) taking inheritances out of the scope of any future property settlement.

Further reading: *Binding Financial Agreements* in the **Structuring and Trusts** folder and *Testamentary Trusts* in the **Estate Planning** folder.

Pensions and Other Superannuation Retirement Benefits

Since 1 July 2007, account based pensions have become the norm in terms of income streams paid by the trustee of an Australian superannuation fund. Like other income streams, account based pensions can be commenced upon attaining age 55 or older, at retirement or post retirement. Some pensions and annuities, however, have not been able to be switched across to the new pension standards, eg lifetime pensions and market linked or term allocated pensions. If paid by a self managed superannuation fund (they will have commenced prior to 2006), lifetime pensions will be funded out of a reserve that needs to be considered in any estate planning for the recipient.

Further reading: *Pensions and Other Superannuation Retirement Benefits* in the **Superannuation** folder.

Superannuation Death Benefits

The method and direction of payment of superannuation death benefits have become a major estate planning issue as a consequence of the build-up of fund member accumulations, account based pensions and their allocated pension predecessors. Since 1 July 2007, the ability of the trustee to pay a death benefits funded pension or annuity has been significantly curtailed by the introduction of a 3rd definition of “dependant” to cover eligibility to receive death benefit income streams. The notable

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difference between an “income stream dependant” and a dependant eligible to receive lump sums is that most adult children are no longer income stream dependants.

The introduction of the new definition of “dependant” is one of 3 key review issues associated with the payment of superannuation death benefits. The 2nd key review issue is the suitability of a fully commutable income stream in the hands of a dependant with poor money management skills and the 3rd is the risk of the wrong person receiving a death benefit – see below.

Further reading: *Superannuation Death Benefits* and *Dependency and Interdependency* and *Implications of Katz v Grossman*, both in the **Superannuation** folder.

Binding Death Benefit Nominations

One of the distinct features of the Australian superannuation régime is the power given to superannuation fund members (if the governing superannuation Deed permits) to provide the trustee of the fund with a nomination as to the payment of death benefits that the trustee usually has to follow. (The Family Court has the power to override a binding death benefit nomination (“BDBN”).

There are a few key review issues that need to be addressed before deciding on whether to make or retain a BDBN:

- Whether the governing Deed permits a BDBN and if so what type, ie lapsing (the usual type offered by externally managed superannuation funds, needing to be confirmed after 3 years of making or last confirmation) or non-lapsing;
- Who would be the decision maker in the event of no BDBN, eg the surviving member or members of a self managed superannuation fund; and
- The taxation implications of making a BDBN and of taking away decision making flexibility, eg to allow the streaming of superannuation to an income stream or death benefits dependant.

Further reading: *Binding Death Benefit Nominations* and *Implications of Katz v Grossman*, both in the **Superannuation** folder.

Review of SMSF Deeds

The inability to make a non-lapsing BDBN is a frequent reason to update a Deed for a self managed superannuation fund. Among the other reasons are the adequacy of the control provisions, the ability to receive co-contributions from spouses, the definition of “dependant” and the ability to pay transition to retirement income streams.

Further reading: *SMSF Deeds – Summary of Clauses* in the **Superannuation** folder.

Life Insurance

The abolition of reasonable benefit limits on 1 July 2007 made it more likely that the tax effectiveness of paying insurance premiums for death and total and permanent disability cover would mean that life insurance policy ownership within superannuation has become more attractive for personal and business equity purposes (but still not appropriate for key person or business debt reduction). On the other hand, the prospect of tax on the payment of death benefits to those adult children who do not qualify as either death benefits or (since 1 July 2007) income stream dependants is a disincentive to the use of superannuation for some people.

Further reading: *Ownership of Life Insurance* (and accompanying tables) in the **Estate Planning** folder and *Ensuring Business Protection and Funded Business Succession Agreements*, both in the **Structuring and Trusts** folder.

Wills and Testamentary Trusts

Apart from the various changes specifically highlighted in this Briefing, there are a series of relatively minor changes that mean that within a few years a Will can become very out of date both from the viewpoint of changing laws and from changes to a Willmakers' circumstances, eg a transfer of wealth into superannuation.

Changing rules relating to means tested pension eligibility are also a need for review, particularly if there is a family member who could benefit from the establishment of a special disability trust.

Further reading: *Testamentary Trusts*, *Wills...Key Clauses*, *Means Tested Pensions* and *Special Disability Trusts*, all in the **Estate Planning** folder.

Role of Executor

The role of executor has long been an important consideration in estate planning. With the shift of wealth away from personal ownership, first to joint tenancies, then also to family and hybrid trusts and (of particular significance in recent times) then to self managed superannuation funds as well, the role of executor has been extended. The extent to which a Willmaker can control the powers, duties and obligations of an executor via the Will in many cases has been diminished.

It is important to review the choice of executor regularly and assess the risk and significance of the opportunity for a family member appointed as executor to act in a self interested manner in respect of decisions regarding self managed superannuation funds and family trusts.

Further reading: *Executors and Administrators* in the **Pocket Summaries** folder.

Capital Gains Tax and Trusts

With non-superannuation trusts that are established by Deed or Will, there are additional CGT issues to consider. The taxation rules applying to trusts mean that capital gains tax ordinarily is borne not by the actual recipient of the capital gain, but proportionately by whoever receives the net accounting income of the trust (see the

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Australian Taxation Office's practice Statement PS LA 2005/1 (GA)). This impacts on the drafting of life interests and capital reserved or protected trusts in particular, as the governing Will (or Deed) should usually ensure that the life tenant or income beneficiary is reimbursed for any capital gains tax liability that they might receive as a result of their income entitlement.

(Unit trusts have a unique CGT provision (CGT Event E4) applying to them that needs to be regularly monitored and anticipated.)

Further reading: *CGT Concessions and Exemptions* and *Small Business CGT Concessions*, both in the **Structuring and Trusts** folder.

Challenges to Deceased Estates, Family Trusts and Superannuation

The disparity of rules governing personally owned assets, family trusts (and other non-fixed trusts such as hybrid trusts) and superannuation means that there remains considerable variation to the extent to which the distribution or control of assets can be challenged on death. Personally owned assets can be challenged in all Australian States and Territories, with a major difference with NSW and the ACT in that challenges made in those States can have regard to distributions of notional estate, ie including family trusts and superannuation. For personally owned real estate, the location of the real estate determines the jurisdiction for challenge; for assets other than personally owned real estate, the domicile of the deceased is determinative. Outside NSW and ACT, challenges to the control of a self managed superannuation fund and to the net assets in a family trust remain difficult. The decisions of the trustees of most externally managed superannuation funds can, in the absence of a valid binding death benefit nomination, be challenged in the Superannuation Complaints Tribunal.

The exposure of a person's wealth to challenge on death will therefore vary considerably from person to person and considerable planning opportunities exist to thwart a challenge.

Quarterly In-house Presentations

As part of Moores Training's presentation service, we provide Victorian firms with a quarterly presentation service focussing on current estate planning, superannuation and structuring issues. The topic for this quarter is "SMSFs – Planning Issues". This topic is also being run at our Box Hill and City offices (see list of forthcoming presentations on the next page). To book in-house presentations, please contact Sue Lee on 9843 2117.

Presentations – February to April 2008

27 February, 10am-1pm	Shepparton	Asset Protection Planning
28 February, 8-10am	Box Hill	SMSFs – Planning Issues
3 March, 4-5.30pm	Yarra Valley	Asset Protection and Estate Planning (<i>part of wider taxation conference</i>)
4 March, 8 – 10 am	Box Hill	SMSFs – Planning Issues
5 March, 9am-12.15pm	Sydney	Testamentary Trusts
6 March, 9am-12.15pm	Melbourne	Testamentary Trusts
6 March, 4.30-6.30 pm	Melbourne	SMSFs – Planning Issues
11 March, 9am-12md	Perth	Estate Planning – Tax and Strategic Issues
11 March, 1-4pm	Perth	Superannuation Death Benefits
14 March, afternoon	Gold Coast	2 nd Generation SMSFs (<i>part of wider superannuation conference</i>)
18 March, 8 – 10 am	Box Hill	SMSFs – Planning Issues
19 March, 4.30 – 6.30 pm	Melbourne	SMSFs – Planning Issues
2 April, 4.30 – 6.30 pm	Melbourne	SMSFs – Planning Issues
3 April, 4.30 – 6.30 pm	Mornington Pen	SMSFs – Planning Issues
8 April, 9am-12.30pm	Port Macquarie	Super for the Future – Investments and Retirement
8 April, 1.30-5pm	Port Macquarie	Superannuation Death Benefits
9 April, 9am-12.30pm	Parramatta	Super for the Future – Investments and Retirement
9 April, 1.30-5pm	Parramatta	Superannuation Death Benefits
15 April, 9am-12.30pm	Melbourne	Asset Protection
15 April, 1.30-5pm	Melbourne	Super for the Future – Investments and Retirement
16 April, 9am-12.30pm	Melbourne	Structuring for “At Risk” Clients – Minimising Director Risk
16 April, 1.30-5pm	Melbourne	Structuring for “At Risk” Clients – Super & Trust Planning Issues
18 April	Perth	Effective Legal Structures for Superannuation (<i>part of super conference</i>)
18 April	Perth	Tax Structures for Closely Held Trading Entities (<i>part of same conference</i>)
30 April, 9am-12.30pm	Sydney	Structuring for “At Risk” Clients – Minimising Director Risk
30 April, 1.30-5pm	Sydney	Structuring for “At Risk” Clients – Super & Trust Planning Issues

Note: Statement of Advice: As with all of the research material on the website, the above material is for general information only & should not be relied on as (or in substitution for) legal, personal financial or other professional advice. See the website for the latest version and cross references.

Further information – www.MooresTraining.com.au:

1. **Website Library:** free access to the Estate Planning, Superannuation, Structuring and Trusts, Pocket Summaries and Newsletters folders
2. **Scheduled Presentations:** see **Forthcoming Presentations** in the **Training Presentations** folder.
3. **Annual Publications:** see **EPSS Advisor Guides**, **Sample Presentation** and **MOORES TRAINING Will Precedent Document Templates** in the **Our Publications** folder.

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See the website for cross-references.**

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